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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

ORIGINAL

In the Matter of)
)
Amendment of Parts 32 and 64 of) CC Docket No. 93-251
the Commission's Rules to Account)
for Transactions Between Carriers)
and Their Affiliates)

REPLY COMMENTS OF BELLSOUTH

BellSouth Telecommunications, Inc. ("BellSouth") hereby offers reply comments in the captioned proceeding pursuant to the Notice of Proposed Rulemaking, FCC 93-435, released October 20, 1993 ("Notice"). Twenty one parties in addition to BellSouth filed comments in response to the Notice.¹

BellSouth strongly opposes the changes to the affiliate transaction rules proposed in the Notice as being unnecessary, unduly burdensome, and contrary to the Commission's stated policy goals. For price cap local exchange carriers ("LECs"), the rationale offered by the

¹In addition to BellSouth, comments were filed by the ALLTEL Service Corporation ("ALLTEL"), American Telephone and Telegraph Company ("AT&T"), the Ameritech Operating Companies ("Ameritech"), the Bell Atlantic Telephone Companies ("Bell Atlantic"), Cincinnati Bell Telephone Company ("CBT"), Coopers & Lybrand, GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE"), the Information Technology Association of America ("ITAA"), the International Communications Association ("ICA"), MCI Telecommunications Corporation ("MCI"), the National Telephone Cooperative Association ("NTCA"), the NYNEX Telephone Companies ("NYNEX"), Pacific Bell and Nevada Bell ("Pacific"), the Southern New England Telephone Company ("SNET"), Southwestern Bell Telephone Company ("SWBT"), Puerto Rico Telephone Company ("PRTC"), Sprint Corporation ("Sprint"), The Public Utility Commission of Texas ("Texas PUC"), the Tennessee Public Service Commission Staff ("TPSC Staff"), the United States Telephone Association ("USTA"), and U S WEST, Inc. ("U S WEST").

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Commission to support the proposed new requirements actually supports the elimination of even the existing affiliate transaction rules.² The record developed in this proceeding fully supports BellSouth's position on each of these points. Ratepayers would be harmed, not benefitted, by the adoption of the proposed rules.

I. The Proposed Affiliate Transaction Rules are Unnecessary.

A prerequisite to the imposition of burdensome new regulatory requirements is a factually supported finding that the existing rules are inadequate to protect the public interest. No such finding can be made on the present record. Indeed, the record demonstrates that the existing rules are more than adequate to protect the public interest. The parties note that the Commission has significantly strengthened the nonstructural safeguards against cross-subsidy since the present affiliate transaction rules were adopted.³ Commenting parties note that the extensive "presents fairly" audits conducted annually by independent accounting firms have not resulted in any significant findings.⁴

BellSouth retained Theodore Barry & Associates ("TB&A") to evaluate the necessity, practicality and cost of

²Accord, NYNEX at 11.

³USTA at 6-7, SNET at 5, Pacific at 7.

⁴U S WEST at 7; NYNEX at 2; Sprint at 5, SNET at 2.

implementing the rules proposed in the Notice. TB&A concludes that the current telecommunications environment already provides adequate incentives for carrier efficiency. Rapid technological developments are eliminating barriers to entry in the local exchange market. Competitors are rapidly entering the market for the LECs' best customers. Regulatory policy at the federal and state level are promoting competition. These forces provide a high level of assurance against cross-subsidization. TB&A's report is attached.

By contrast, those parties supporting the proposed rules provide no factual predicate for their adoption. The Texas PUC and ITAA simply express support for the tentative conclusions in the Notice with no underlying analysis.⁵ MCI provides no factual support for its allegation that affiliate transactions are "an area that historically has been subject to considerable carrier abuse."⁶ ICA recognizes the need for a factual record to support the proposed rules, and recognizes that such a factual predicate is not provided in the Notice.⁷ ICA also recognizes that any examples of alleged abuse of the existing rules by price cap LECs, to be relevant, would have to have occurred after

⁵Texas PUC at 2, ITAA at 2.

⁶MCI at 1.

⁷ICA at 6.

the implementation of price cap regulation.⁸ ICA's comments contain no allegations of abuse of the existing rules by price cap LECs during this time period. If the Commission believes that abuses have occurred that support the need for new rules, it should provide interested parties an opportunity to comment on these allegations.

The TPSC Staff requests that the Commission adopt rules that specifically require that both the FCC and the state Commissions have access to the books and records of nonregulated affiliates of carriers for verification purposes.⁹ Such a requirement is neither necessary nor lawful. BellSouth already makes available to its regulators all information necessary to ensure compliance with the Commission's affiliate transaction rules. Sections 218 and 220(c) of the Communications Act guarantee access to records of regulated carriers and their affiliates needed by the Commission to carry out its statutory responsibilities, and state statutes contain similar rights of access. However, nothing in the Communications Act authorizes the Commission to delegate its right of access to third parties such as state commissions.

II. The proposed rules are unduly burdensome.

There is virtually universal recognition in the comments of the parties that the proposed rules would be

⁸ICA at 7.

⁹TPSC Staff at 3.

extremely burdensome to implement.¹⁰ AT&T describes the implementation costs as "staggering".¹¹ Sprint describes the proposed rules as a "waste".¹² Coopers & Lybrand notes that the proposed rules "will add substantial difficulty to the Carrier's affiliate transaction process."¹³ Pacific notes the inconsistency of the proposed rules with Vice President Gore's report on reinventing government, and the Commission's own estimate that the proposed rules will add 320,000 hours burden to carriers.¹⁴ Even ICA and MCI, which support the adoption of the proposed rules, recognize their burdensome nature.¹⁵

USTA estimates the cost of obtaining some of the estimated fair market value ("EFMV") studies that would be required under the new rules at \$91 million for the Tier 1 LECs.¹⁶ GTE estimates its additional cost at \$11.5 million.¹⁷ NYNEX estimates that it would incur external

¹⁰ALLTEL at 2; USTA at 10; U S WEST at 9; NYNEX at 19-20; SWBT at 2-3; GTE at 2.

¹¹AT&T at 15.

¹²Sprint at 8, fn. 13.

¹³Coopers & Lybrand at 1.

¹⁴Pacific at 6.

¹⁵ICA at 11; MCI at 14.

¹⁶USTA at 10. This estimate does not include services for which no estimated fair market value would be available, the costs that would be incurred by smaller LECs, or the administrative costs necessary to implement the proposal.

¹⁷GTE at 2.

costs of \$35,000 to \$40,000 for each service studied, with over 500 projects to be valued.¹⁸

BellSouth asked TB&A to evaluate the feasibility of obtaining EFMV analyses for services transactions, as would be required under the proposed rules. In the attached analysis, TB&A concludes that it is not feasible to implement the proposed rules. True estimates of fair market value will not be available in most cases. Furthermore, the cost to acquire EFMV for services transactions would be prohibitive. Finally, the output of the EFMV analyses will be inherently unreliable.

TB&A conservatively estimates a portion of the recurring annual cost to BellSouth and its affiliates to meet the EFMV study requirement of the proposed rules to be \$14.4 million. This estimate does not include the initial "one-time" implementation costs, the increased internal costs needed to monitor the new process, the increased cost of the annual independent audit, or the cost of lost efficiencies from a reduction in beneficial affiliate transactions. The actual cost burden of the proposed rules would be significantly higher than the amount quantified by TB&A.

The Commission should not impose costs of this magnitude on the industry in the absence of a compelling public policy or consumer protection imperative. The record

¹⁸NYNEX at 19.

in this case makes it clear that no such imperative exists. Indeed, TB&A was not able to identify any tangible benefits associated with the proposed EFMV approach. Therefore, the proposed rules should not be adopted.

III. The Proposed Rules Are Contrary to the Commission's Stated Policy Goals.

A. The Proposed Rules Will Impair Carrier Efficiency.

In adopting price cap regulation for the large LECs, the Commission increased the incentives for efficiency enhancing behavior. Correspondingly, it reduced the need for inefficient regulations designed to correct the perverse incentives inherent in cost of service regulation. The Commission proposed to rely on market forces in lieu of regulation whenever possible. Where sufficient competition had not yet developed to rely exclusively on market forces, the Commission implemented a regulatory regime that duplicated the incentive structure of a competitive marketplace. The rules proposed in this proceeding could hardly be more at odds with these initiatives. The proposed rules are inefficient, and should be rejected.

Sprint notes that "the increased work effort and expense [to develop EFMV for services] will be the very antithesis of efficiency."¹⁹ U S WEST asserts that "the proposed rules would impose a significant incremental economic burden on the industry and eventually on the

¹⁹Sprint at 20, fn. 31.

ratepayers for preventative measures that would have no purpose."²⁰

In adopting the present joint cost rules, the Commission noted that the use of fully distributed cost as a transfer price would enable consumers to benefit from scale and scope economies and from shared corporate overheads. Several parties note that the antipathy to affiliate transactions apparent in the Notice is inconsistent with these prior findings, and could eliminate these consumer benefits.²¹

B. The Proposed Rules are Anticompetitive.

In its comments, BellSouth demonstrated that the proposed rules would confer an unearned advantage to competitors of regulated carriers by increasing the carriers' cost, but not that of their competitors. A number of parties concur that the proposed rules would have an anticompetitive effect.²²

The most vocal proponent of the proposed rules is MCI. Although its comments are presented as a customer of LEC access services, its recently announced plans to become a

²⁰U S WEST at 9.

²¹ALLTEL at 2; NTCA at 3; GTE at 17-18; SWBT at 21; NYNEX at 22; U S WEST at 13-14; Sprint at 15-16; Bell Atlantic at 6, 8-9; USTA at 3; AT&T at 15-16; CBT at 4-5; Pacific at 5-6.

²²AT&T at 15-16; Bell Atlantic at 9-10; Pacific at 4; SWBT at 24; USTA at 12-13.

full scale competitor of the LECs in the local markets²³ reveals its true interest.

MCI's Chairman is quoted in the Wall Street Journal as stating: "We want to be a local phone company and expect to be."²⁴ MCI announced plans to spend \$20 billion over a six year period "aimed at upgrading the company's networks and breaking the Baby Bells' monopoly over local phone service."²⁵ Construction of its first network is already underway in Atlanta, BellSouth's largest market.²⁶

As a strategic competitor, MCI has every incentive to use the regulatory process to seek an unearned competitive edge. By hobbling the LECs with costly, unnecessary regulatory burdens that it does not share, MCI can secure an anticompetitive "umbrella" to ease its entry into the local markets. If the Commission wants to foster a truly competitive market, it must reduce, not increase, the regulatory burdens that apply to only one competitor in the market. It can do so by eliminating the existing affiliate transaction rules for price cap LECs.

IV. Conclusion.

The record clearly demonstrates that there is no basis for the Commission's proposal to adopt much more onerous

²³Wall Street Journal, January 5, 1994, pages A3-A4.

²⁴Id.

²⁵Id.

²⁶Id.

affiliate transaction rules. To the contrary, the Commission should eliminate the existing affiliate transaction rules for price cap carriers.

Respectfully submitted,

BELLSOUTH TELECOMMUNICATIONS, INC.

By its attorney:

A handwritten signature in cursive script, appearing to read "M. Robert Sutherland", is written over a horizontal line.

M. Robert Sutherland
4300 Southern Bell Center
675 West Peachtree Street, N.E.
Atlanta, Georgia 30375
404 529-3854

January 10, 1994

**Analysis of Proposed Use of
Estimated Fair Market Value
(FCC Docket No. 93-251)**

**BellSouth Telecommunications, Inc.
Atlanta, Georgia**

**Prepared by:
Theodore Barry & Associates
January 10, 1994**

January 10, 1994

Mr. M. Robert Sutherland
General Attorney
BellSouth Telecommunications, Inc.
675 West Peachtree Street
Suite 4300
Atlanta, GA 30375

Dear Mr. Sutherland:

Theodore Barry & Associates has completed an analysis of the proposed use of estimated fair market value as presented in the FCC's *Notice of Proposed Rulemaking* released October 20, 1993 (Docket No. 93-251).

The conclusions reached in our analysis are consistent with our initial conclusions that were included in the BellSouth Comments to the FCC on December 10, 1993. In summary, we believe that the FCC proposed requirement of comparing fully distributed costs for services to estimated fair market value is neither feasible nor necessary. Our report is enclosed.

Sincerely,



Stephen P. Budd
Managing Director

enclosure

Analysis of Proposed Use of Estimated Fair Market Value

Objective

Theodore Barry & Associates (TB&A) was engaged by BellSouth Telecommunications, Inc. (BST) to analyze certain aspects of the FCC's Notice of Proposed Rulemaking (NPRM), released on October 20, 1993 (Docket No. 93-251). Our analysis focused on the sections of the NPRM related to the proposed use of estimated fair market value (EFMV) for services.

TB&A Qualifications

TB&A is a general management consulting firm specializing in the telecommunications and energy industries. TB&A has long assisted both regulatory commissions and companies in assessing management and operational practices, such as planning and organization, and in various regulatory matters, such as affiliate relations and alternative regulatory frameworks. TB&A is headquartered in Los Angeles and maintains offices in New York, Chicago, and Atlanta.

Overall Conclusions

The FCC intent in this Docket of minimizing inefficiencies that could potentially be passed into regulation - in fact potentially mandated into regulation through the Affiliate Transaction Rules of 32.27 - is worthwhile. There is little justification for affiliates being able to receive full compensation from carriers for charges resulting from inefficient affiliate operations. However, while the intention is worthwhile, the proposed approach of requiring carriers "to estimate the fair market value of all non-tariffed affiliate transactions for which we [FCC] do not permit prevailing company pricing" is neither feasible nor necessary.

The FCC proposal is not feasible for several reasons. First, a "true" EFMV, as determined through a prevailing market, generally is not available for comparison to fully distributed cost (FDC), by definition. If a prevailing market was available, and the affiliate "participated" in this market, the "residual rule" of the Part 32 transfer pricing hierarchy (i.e., FDC) would not be needed since the "general rule" (tariff then market) would apply. In the absence of a prevailing market rate, comparisons with potential alternative providers must act as a proxy. The applicability of alternative provider analyses, however, is largely dependent on the nature of the service. We have found it helpful, for purposes of this and other studies, to categorize services as transaction-based (i.e., readily definable, routine), knowledge-based (i.e., difficult to define, non-routine) or a combination of the two. Significant potential limitations for alternative provider analyses apply to some extent to all

services. Second, the costs required to comply with the EFMV pricing rule will be in excess of any benefits. In fact, we have been unable to identify any tangible benefits associated with the proposed EFMV approach, besides perhaps the perceived additional level of comfort of knowing that some attempt has been made to determine EFMV. Third, we believe that the alternative provider analyses will be of questionable usefulness since, without exhaustive guidelines, the analyses will be extremely inconsistent in their approach and interpretation among carriers. In addition, through varying levels of discipline, these analyses are susceptible to distortion.

It is TB&A's opinion that the EFMV tests proposed by the FCC are not needed. Adequate incentives, inherent in competition and incentive regulation, already exist for carriers to be efficient.

The remainder of this report is organized to follow and support these conclusions.

Analysis of Notice of Proposed Rulemaking

Requiring Comparison with EFMV is not feasible.

- **True EFMV is not available in most cases.**

Ideally, the EFMV of services provided by affiliates would be determined by comparison to prices that others would pay to acquire those services, in other words, the "market rate" prescribed in the FCC Part 32 rules. In lieu of an established market rate, the NPRM proposes that fully distributed costs (FDC) be applied only to the extent that FDC is less than EFMV. No guidance is offered in the NPRM on how to determine EFMV where no market rate exists.

Absent a market rate, in TB&A's view, EFMV can be determined only by comparisons with outside vendors, or alternative service providers. The remainder of our analysis is framed around the need to use alternative provider comparisons as a proxy for EFMV.


- **The degree to which it is possible to determine EFMV is largely dependent on the nature of the service.**

In describing the nature of services, TB&A has found it helpful to define two general categories of service:

- Transaction-based services are operational services which usually involve routine, repetitive, production-oriented activities. For these services, such as shareowner services and accounts payable, it is possible to clearly define an end work product.

- Knowledge-based services are services which involve planning and strategy development. As is expected, those types of services are non-routine and non-repetitive and produce a less clearly defined work product. Typically, planning activities, such as strategic planning and tax planning, are incorporated into knowledge-based services.

In practice, services are rarely purely transaction-based or knowledge-based. It is more common for services to fall somewhere on a continuum between these two categories, as shown below:

	Transaction-Based Services	Knowledge-Based Services
		
Characteristics		
• Nature of Service	Operational	Planning
• Work Process	Routine	Non-Routine
• Service Definition	Clearly Defined	Not Clearly Defined
• Primary Work Product	Product-Oriented	Issue/Oversight-Oriented
Implications		
• Availability of Alternative Providers	High	Low
• Usefulness/Objectivity of Alternative Provider Analysis	High	Low
• Cost of Alternative Provider Analysis	Low	High

As indicated above, in the case of transaction-based services, availability of potential alternative providers is relatively high, as is the general usefulness and objectivity of alternative provider comparisons. In the case of knowledge-based services, the availability of potential alternative providers is relatively low, as is the usefulness and general objectivity of alternative provider comparisons. Due to the difficulties associated with defining the services and identifying realistic alternative providers, the costs for performing alternative provider analyses for knowledge-based services are significantly higher than for transaction-based services.

- **Significant potential limitations for alternative provider analysis apply to some extent to all services.**

The category of the services, as described above, has a direct impact on the ability of a carrier to determine EFMV. However, even for transaction-based services, several potential limitations apply that must be considered in interpreting the results and affixing a level of confidence to the analysis:

- Ability to define the full scope of services
- Ability to identify the actual cost of services
- Ability to specify service levels
- Ability to identify feasible alternative providers
- Ability to obtain realistic and representative prices
- Ability to integrate alternative provider services effectively into corporate processes.

Generally, these limitations are more constraining for knowledge-based services and of lesser concern for transaction-based services.

- **Costs required to comply with the EFMV pricing rule will be in excess of any potential benefits.**

While the ultimate objective of minimizing potential inefficiencies that could be passed into regulation is worthwhile, TB&A has been unable to identify any tangible benefits associated with the proposed EFMV approach. Thus any incremental costs associated with this element of the NPRM most likely would exceed its benefit. The costs estimated in this section are the BST and affiliate costs associated with the NPRM.

- **The costs of complying with the EFMV pricing rule requirements are dependent upon the nature of the service.**

The distinction between transaction-based and knowledge-based services in terms of usefulness and feasibility is important in terms of the cost required to determine EFMV. Transaction-based services tend to lend themselves to estimates of fair market value, through a competitive bidding process, far more readily than do knowledge-based services. The cost of establishing an EFMV for a transaction-based service would resemble the costs incurred by the purchasing function for procurement of any routine service. On the other hand, EFMV for knowledge-based services, such as Research and Development (R&D) projects, are extremely difficult to estimate, requiring a great deal of subjectivity to arrive at the "value" of what is often an intangible service. This complexity will result in increased costs.

- **The majority of BST affiliate transactions priced at FDC represents knowledge-based services or a combination of transaction and knowledge-based (hybrid services). Few services are transaction-based.**

BST affiliate products and services priced at FDC are provided primarily by three entities:

- BellSouth Corporation (BSC)
- Bell Communications Research (Bellcore)
- BellSouth Business Systems (BBS).

While other affiliates provide a few services at FDC, the affiliates above represent the majority of affiliate transactions impacted by the EFMV proposal and are the focus of our analysis. A brief description of each affiliate, and a list of the products and services provided to BST, is provided in the Cost Allocation Manual (CAM) filed by BST with the FCC and is summarized below. A more detailed set of exhibits identifying the affiliate transactions provided as well as the individual service classifications is included in **Attachment A**.

BellSouth Corporation (BSC)

BellSouth Corporation is the parent corporation of BST, as well as various nonregulated subsidiaries that are engaged in businesses other than the provision of regulated local exchange service. Services provided to BST by BSC at FDC include financial, legal, planning, personnel, public affairs, public relations, accounting, security, and executive support services. Conservatively we estimate that 220 BSC services are provided to BST that are priced at FDC. A general estimate of the distribution between transaction-based and knowledge-based services is shown below:

Transaction-based services	15	(7%)
Hybrid services	22	(10%)
Knowledge-based services	183	(83%)

Bell Communications Research (Bellcore)

Bell Communications Research (Bellcore) is jointly owned by the seven Regional Bell Holding Companies. BST is the shareowner of the one-seventh share of Bellcore and is the primary liaison with Bellcore, and its wholly owned subsidiary, Database Service Management, Inc. (DSMI). Bellcore services are provided through discrete research and support projects to BST and its other shareowners. The services provided by Bellcore to BST at FDC include marketing, national security, emergency preparedness, procurement, quality assurance, information systems, training, network, accounting, and regulatory support services. Conservatively we estimate that 225 Bellcore services are provided to BST that are priced at FDC. A general estimate of the distribution between transaction-based and knowledge-based services is shown below:

Transaction-based services	10	(5%)
Hybrid services	149	(66%)
Knowledge-based services	66	(29%)

BellSouth Business Systems, Inc. (BBS)

BellSouth Business Systems, Inc. (BBS) is a wholly owned subsidiary of BST and is a holding company for BellSouth Communications, Inc.; BellSouth Communications Systems, Inc.; Dataserv, Inc.; BellSouth Advanced Networks, Inc. ; and BellSouth Financial Services Corporation. Services provided to BST by BBS companies at FDC include sales, marketing, government compliance, incidental network maintenance and testing, technical support, and systems integration and support services. Conservatively we estimate that 32 BBS services are provided to BST that are priced at FDC. A general estimate of the distribution between transaction-based and knowledge-based services is shown below:

Transaction-based services	12	(38%)
Hybrid services	9	(28%)
Knowledge-based services	11	(34%)

- **Implementation of the proposed EFMV pricing rule will result in substantial recurring fixed and variable costs as well as implementation costs.**

The proposed EFMV pricing rule will result in substantial cost to BST and its affiliates. These costs include both implementation (one time) costs and program administration (recurring) costs. The types of activities that would likely generate the majority of the costs associated with implementing and administering the proposed NPRM, or "cost drivers," are presented in **Attachment B**. In addition to quantifiable costs, other economic costs will be incurred due to delays in service procurement resulting from the EFMV testing, increased internal regulatory compliance, and the establishment of an artificial hurdle that potentially would inhibit mutually beneficial affiliate relationships. These unquantifiable costs will result in an additional impact beyond the estimates that we provide in this report.

TB&A estimates that the approximate cost of performing the EFMV test on a per service basis will vary from a low of \$20,000 for a purely transaction-based service to a high of \$70,000 for a purely knowledge-based service. For hybrid services, actual costs may range between these two figures, depending on the complexity of the transaction to be tested. Roughly the middle of this range, \$45,000, is a representative cost estimate for a hybrid service. A description of the methodology employed to arrive at these estimates is provided in **Attachment B**.

TB&A would expect that, when possible, BST and its affiliates would attempt to reduce the cost of determining EFMV by grouping services and requesting quotes on a group of services. This is only possible when groups of "like services" (well defined and possessing the same characteristics) can be cost effectively packaged for the bidding process.

For the purposes of TB&A's analysis, we have assumed that each Bellcore service, on average, could be grouped with one other like service for EFMV testing, reducing the number of EFMV tests by 50%. Similarly, TB&A estimates that, on average, each BSC service could be grouped with one other like service for EFMV testing purposes. TB&A does not believe that such "grouping" is possible or practical in the case of BBS services.

Grouping of services results in a total of 255 equivalent EFMV tests, with an annual recurring cost of approximately \$14.4 million. It is important to note that these estimates do not include the majority of the costs listed in the "Cost Drivers" section of Attachment B, since some costs cannot be quantified at this time.

- **EFMV analyses will be of questionable usefulness.**
 - **EFMV analyses will be inconsistent.**

As stated in the NPRM, "instead of specifying those steps, we propose to require carriers to attempt in good faith to determine whether fair market value exceeds cost..." While theoretically the methodologies available to perform alternative provider analyses are limited, in practice numerous methodologies have been applied. Many of these methodologies address perceived value from the service recipient's viewpoint, but not necessarily "fair market value," in either their conceptual approach or their application. Based on the nature of the service and the purpose of the analysis, authors of these studies typically devise study approaches that select from numerous possible analysis criteria and gather data in varying levels of detail. Examples of criteria that TB&A and others have used include necessity of the service, organizational placement, fairness of cost allocation, and cost-reduction initiatives.

In TB&A's view, a major challenge for the use of estimated fair market value, as prescribed in the FCC Docket, is ensuring consistency in approach and interpretation, both within and among the carriers. This most likely would require a detailed set of guidelines that would specify the worksteps and level of effort required in order for the "good faith" alternative provider comparison to be deemed completed. Areas where inconsistency in approach and interpretation most likely would occur, and where guidelines would be required, include the following:

- How to define the service to be compared
- How to capture the full set of costs for the service (It is important to note that accounting/reporting systems that currently provide fully distributed cost information for Part 32 purposes typically capture information by functional areas, responsibility centers, and/or cost pools. Cost information for products/services will require a different accounting/reporting structure.)
- How to specify the levels and quality of service to be provided
- How to identify realistic alternative providers
- How to weigh qualitative factors such as breadth of services, delivery time and responsiveness, and financial stability.

- **EFMV analyses can be easily distorted.**

Each of the activities listed above is a formidable task which, for the most part, aligns with the potential limitations discussed earlier. A high level of discipline will be required to produce meaningful analyses since undue casualness or expediency in any of these tasks could compromise the entire analysis.

Requiring comparison with EFMV is not necessary since adequate incentives for efficiency already exist.

In TB&A's view, the current telecommunications environment already provides sufficient incentives to ensure efficiency. The inexorable forces of technology, markets, and regulation continue to undermine many of the assumptions upon which decades of regulation were founded. Regulators and policy makers generally recognize that as competition in the local exchange area expands, the need for regulation to serve as a surrogate for the marketplace is lessened. Many recent regulatory initiatives, both at the federal and state level, have been designed to expedite this transition. It is genuinely felt within the industry that any local exchange company (LEC) that fails to prepare immediately for full competition, and instead seeks refuge in its monopoly status, is doomed.

Rapid developments in technology are eliminating many of the barriers to entry in the local exchange market that existed only a few years ago. New forms of digital wireless technology are being developed and deployed that will make it possible for competitors to offer alternative local services to many of the LEC's best customers. Equipment vendors are developing products and services that will enable cable TV operators to offer telephone service on their existing cable facilities. The LECs can no longer rely on the protection of regulators to thrive or even survive. Rather, economies of scale and scope, i.e., efficiency, and engineering expertise, will be required.

There is little question of the desire and intent of competitors to enter the local exchange business. The recently announced ventures by major industry participants, such as AT&T and McCaw Cellular, U.S. West and Time Warner, Bell Atlantic and TCI, and the recent announcement by MCI to enter the local exchange business, all suggest that competition will be formidable. A primary way that LECs can respond to these new entrants is by dramatically reducing their cost structure. All LECs have begun this process, to some extent, through reengineering efforts, force reductions, and reorganizations. They have no incentive nor inclination to absorb costs from affiliates that exceed fair market value as that would only make them less competitive.

Regulators at the federal and state level have initiated various proceedings and enacted policies that are clearly designed to promote competition. The implementation of Open Network Architecture (ONA), collocation, interconnection, and intraLATA toll competition have sent a resounding message to LECs that they must prepare for increasing levels of competition. The adoption of incentive regulation and other alternative regulatory mechanisms is designed to sever the link that previously existed between costs and rates. Under these new regulatory frameworks, LECs can achieve higher earnings by reducing their costs and stimulating revenues. The motivation to cross-subsidize non-regulated operations is essentially eliminated under this regulatory arrangement.

The technological, market, and regulatory trends that currently impact LECs provide significant incentives for efficiency and a high level of assurance against cross-subsidization. The challenges that face this industry with respect to pending competition are quite significant and they represent the ultimate constraint against any abuse. Cross-subsidies only serve to burden the LECs and are completely inconsistent with the direction that telephone company executives are moving. Regulators have long sought to operate as the surrogate for the marketplace. That marketplace is now on the doorstep of the LECs and there is no longer any tolerance for inefficiencies, including and especially those that may be caused by affiliates.

Concluding Remarks

TB&A believes that monitoring affiliate transactions using the current rules remains the most effective approach to the issues being raised in the NPRM regarding the use of EFMV. Alternative regulatory frameworks together with competition provide more than adequate incentives for ensuring efficiency in affiliate transactions.

Attachments

***Attachment A - Classification of services provided to BST
(Transaction-based v. Knowledge-based)***

- **BellSouth Corporation (BSC)**
- **Bell Communications Research (Bellcore)**
- **BellSouth Business Systems (BBS)**

Attachment B - Cost Impact of EFMV on BST and affiliates

- **Cost Estimate Methodology**
- **Assumptions**
- **Cost Drivers**
- **Cost Estimate Calculations**
 - **Cost per EFMV test**
 - **Cost Estimate**

BSC Services Provided to BST at FDC

Transaction-Based
Services

Knowledge-Based
Services



Advertising

- Supervision of BellSouth Telecommunications advertising. X
- Negotiation and establishment of corporate-wide Master Agency
Contracts used by advertising groups in all entities. X
- Coordination of advertising strategies and policies for the
Corporation. X
- Provision of market research for advertising target audiences and
evaluations of advertising effectiveness. X
- Management of the corporate identification and graphics
standards for BellSouth and subsidiaries. X

Assistant Secretary/Corporate Counsel

- Advice and review as to shareholder matters, proxy
development, corporate governance practices, and other
miscellaneous corporate matters. X
- Compliance with all federal, state, and foreign securities laws,
SEC rules and regulations, state and foreign corporate laws, and stock
exchange requirements (foreign and domestic). X
- Counsel to BellSouth Headquarters and Board of Directors on
corporate law and practice. X
- Coordination of actions and materials that require Board approval. X

Comptrollers

Accounting Services

- Billing, accounts payable, property records, classification,
corporate books and reports services for BellSouth Headquarters,
BellSouth D.C. and BellSouth Capital Funding Corp. X
- Implementation and maintenance of PC-based systems to enhance
the efficiency and effectiveness of the Comptrollers organization. X

Compensation and Benefits

- Corporate-wide payroll services for officers of the corporation. X
- Corporate-wide accounting research and policy development
with respect to employee benefit plans such as pensions, savings
plans, ESOP, etc. X
- Corporate-wide accounting research and policy development
with respect to executive and key manager compensation plans such
as deferred compensation, stock options, etc. X

BSC Services Provided to BST at FDC

Transaction-Based
Services

Knowledge-Based
Services



Comptrollers (Cont'd)

Corporate Consolidations and External Reporting

- Subject matter expertise on the Securities Act of 1933 ("33 Act"), the Securities Exchange Act of 1934 ("34" Act) and the 1939 Trust Indenture Act. X
- Preparation and filing of all "33 Act" registration statements for BellSouth and subsidiaries. X
- Preparation and filing of all required "34 Act" filings for BellSouth and subsidiaries. X
- Assisting Secretary in preparation and filing of the BellSouth Notice of Annual Meeting and Proxy statement. X
- Controlling the BellSouth consolidation process, including providing instruction on consolidation to other BellSouth entities. X
- Monthly consolidated regional financial reports compiled from subsidiary data transmissions. X
- Quarterly and annual financial statements for BellSouth and subsidiaries. X
- Analysis and interpretation of accounting pronouncements which affect the company's disclosure requirements. X

Corporate Accounting Policies and Standards

- Participation in external accounting and regulatory standard setting forums (FASB, SEC, etc.) X
- Establishment and communication of corporate accounting policy resulting from pronouncements issued through GAAP, FASB, and SEC releases. X
- Financial and accounting research services for the subsidiaries. X
- Policies and procedures for BellSouth Headquarters general service and project billings. Provide support for regulated witness justification of methods and billing amounts. X
- Interpretation of provisions regarding Executive Instructions and Executive Directives. Issuance of new and revised provisions and assistance in implementing these instructions. X